The Surety & Fidelity Association of America
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AMERICAN INSURANCE ASSOCIATION

December 7, 2016

The House Committee on Commerce and Trade
The Honorable Joseph Graves, Chairman
Anderson House Office Bldg.
S-985 House Office Building
Lansing, MI 48933

RE: SB 627

Chairman Graves and Committee Members:

Thank you for allowing me on behalf of The Surety and Fidelity Association of America and the American Insurance Association to provide written testimony relative to SB 627, the bill before you dealing with Public Private Partnerships or P3s. I regret that I can't be there in person today due to the short notice of the committee hearing but I wanted to convey some important thoughts and comments on the legislation.

Government entities in the United States have understood the importance of surety bonds and have required bonding for over a century to provide performance and payment assurance for the nation's infrastructure projects. Although procurement methods have evolved—including the increased use of public-private partnerships (P3s) under consideration in Michigan SB 627--the construction risks remain the same, making surety bonds just as relevant and important today in the P3 legislation in Michigan.

The surety's underwriting of a bond is crucial to the success of public works projects. The surety provides a bond only to contractors that, after the surety's evaluation, are capable of performing the work. The surety examines the contractor's expertise in the work, ability to work in the region where the project is located, all the jobs that the contractor has on-going, overall management and financial standing to complete the contract, including its capital and record of paying its obligations. By issuing a bond, the surety provides the public contracting entity with assurance from an independent third party, backed by the surety's own funds, that the contractor is capable of performing the construction contract.

The performance bond guarantees that the public works project is completed according to the construction contract. If a performance bond is not provided, the public entity and its taxpayers take on the risk should the contractor default, and bear the burden of re-letting work and paying any excess completion costs. The completion costs for a defaulted project cannot be estimated with certainty, but typically are higher than anticipated. By contrast, when a performance bond is in place, the full amount of the bond is available to complete the construction contract in the event of the contractor's default.

Public entities often do not have adequate resources to perform all of the tasks that the surety does, either in prequalification of contractors or adjusting the claims that result from a contractor default. Bonding is a cost-effective way for a public entity to protect itself and the project in the event of default.

The payment bonds guarantee laborers, subcontractors, and suppliers that they will get paid for their work and materials. Payment bonds are a critical protection for small, emerging, and minority contractors, since they are more likely to start as subcontractors on projects. Without bonds, subcontractors and suppliers either have to risk losses from nonpayment that they cannot afford, or not work on the public jobs for which they are qualified. Construction is a risky business, and performance and payment assurance is necessary.

A P3 is simply another method to deliver a public works project. Although the public works project in a P3 is not financed initially with public funds, public funds in the form of some future revenue stream (e.g. tolls, availability payments, tax credits, loans) are committed to the private partner upfront in the P3 agreement and ultimately are the source of funding and the profits/return on investment for the private partner and the investors.

The end result of construction in a P3 is for the public use and benefit. The chief interest of a public entity is whether the public works project will be available for the public to use and whether subcontractors and suppliers get paid. That interest is the same no matter if the public works project is delivered through a P3 or a more traditional method of procurement, and as such we believe Michigan SB 627 should require bonding. We recommend that Section 11(c) be amended and that a new subsection (3) be added to Section 11, as follows:

(c) **With respect to portions of the qualifying project other than construction, reconstruction, rehabilitation, improvement and repair,** p~~P~~rovisions requiring that the private party or 1 or more of its prime contractors provide proposal, performance, or payment security. Performance or payment security if required may be in the amounts determined by the public authority and in the form of bonds, guarantees, letters of credit, committed equity, or any other type of financial instrument, or any combination of the foregoing, each as determined by the public authority.

(3) **The public-private agreement shall contain a** p~~P~~rovision requiring that the private party or 1 or more of its prime contractors provide proposal, performance **and** or payment ~~security~~ **surety bonds to secure the construction, reconstruction, rehabilitation, improvement and repair portions of the qualifying project. The amount of such bonds shall be the estimated total cost of said construction, reconstruction, rehabilitation, improvement and repair. The notice requirements, eligible claimants and suit limitations under such bonds shall be governed by MCLA § 129.201 *et seq*.**

Also, we suggest that "and sureties" be added to the end of Sec.5 (c) (ii)(B):

(ii) Agreements between the public authority and 1 or more of the following:

(A) A private party
(B) A private party's lenders **and sureties**
(C) Federal, state and local governments

We trust you will consider these proposed changes as improvements to very important legislation and stand ready to assist you if needed.

Please contact me with additional questions. Thank you.

Sincerely,

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Surety Bonds are Essential to the Success of Public Private Partnerships

--Public-private partnerships (P3s) are just another method to deliver a public works project
The end result of any P3 project is a completed project for a public use, such as a road, government building or a waste water treatment facility. Construction under a P3 ought to be bonded just the same as any other public works project.

--Public funds ultimately pay for a P3
The public entity and the private partner enter a long-term agreement in which the public entity commits a stream of revenue to repay the private partner's upfront financing so that in the end, the taxpayer pays for the project, plus a profit for the private partner.

--The construction risk in a P3 is the same as any other construction project
Construction is a risky business, and contractors perform more than one project at a time. It is not uncommon that the loss that causes the collapse of a company is not the job being performed for the public entity, but one of its other projects. Arguably, the risk to the public entity is increased in a P3 since the public entity is responsible to the taxpayers to deliver a public service or facility, but the public entity does not choose or control the construction contractor and could suffer financial loss if the private partner defaulted.